WHAT SHOULD BE THE ATTITUDE OF THE STATE TOWARD THE BUSINESS OF FIRE INSURANCE?

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I know of no more interesting present-day problem than that which has grown out of the efforts that are now being made, in many parts of the United States, to fix and control fire insurance rates by governmental action. Of course, it is only a single phase of a very large movement that is in progress throughout the civilized world looking toward the strengthening of governments in their powers of control over private business. But, from certain points of view, the business of fire insurance seems, in a very particular sense, to be one which can be better conducted by private individuals than by even the most perfect governmental machinery. It seems to possess certain features which make it a particularly dangerous field for the people in their organized capacity to attempt to enter. A good many kinds of business lend themselves quite easily to the designs of those who would like to see a socialistic State established here with the least possible delay. The idea of governmental operation presents no insurmountable difficulties in a number of cases. But in the case of fire insurance, our present-day reformers and radical thinkers, bent on driving private capital out of the field and leaving this in the exclusive control of government, are confronted upon the threshold by unusual obstacles which are inherent to the business itself, and few suggestions have yet been made, of a practical nature, respecting the manner in which these obstacles can be avoided. Notwithstanding all this, however, it is no overstatement to say that, at the present time, a very formidable and aggressive movement is on foot, having for its ultimate purpose the virtual transaction of the business of fire insurance by government.

What is the peculiar feature of the fire insurance business which makes the problem of State participation in this business a more difficult one than the corresponding problem in the case of railroads, for instance, or of water companies, or of telegraph

and telephone companies? Well, broadly speaking, what I refer to is of course the fact that fire insurance has always been, and must always be, to an extent not approached by any other legitimate business I know of, a game of chance pure and simple — a game of chance in which men who are qualified by temperament and experience to play it, and who are willing to risk their money in it, can survive, but in which none but experts can with any safety engage. If it were not that the word has acquired a sort of invidious meaning which makes it unsafe to use it in connection with any legitimate business, I should be inclined to use the word "gambling" in trying to describe the exact feature of the business of fire insurance that I am referring to. It would be obviously improper, however, to attempt to completely characterize by any such word a business so beneficial to the entire world as the business of fire insurance is when it is properly conducted. But that the uncertainties and extraordinary hazards which attach to all games of chance enter into the transaction of this business to a very remarkable degree, cannot be denied. It is this element in fire insurance which seems to require that it shall remain in competent private hands longer than most other kinds of enterprise — for I am assuming that all of us will agree that the State is no fit agency for the transaction of business into which the element of chance and guess-work enters to any abnormal extent.

Now, of course, the attitude of fire-insurance underwriters toward governmental activities in connection with their business has, to a large degree, been influenced and controlled by the circumstances to which I have referred. Broadly speaking, it is a very different attitude indeed from that which has been adopted during recent years by the leaders in the life insurance field. Recognizing, in the first place, that their responsibilities are peculiarly fiduciary in character — recognizing also, the fact that mortality tables have made their business practically an exact science out of which, when properly conducted, the element of chance can be kept entirely — life-insurance men have for sometime past treated the whole question of State participation in company affairs as something which is not only inevitable, but, on the whole, desirable and proper. At least, they have not

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bitterly contested the steady growth which has been going on in the powers of supervisory departments. In the case of fire insurance, on the other hand, nearly every step which has been taken in the direction of an increased governmental control over the business, has been sharply opposed. Particularly has this been true with respect to legislation affecting that most occult and difficult branch of the fire underwriters' art — namely, the making of rates. With the evident fear present in their minds that even little steps by the State in that general direction can mean nothing but a dangerous departure toward actual governmental rate-making fire underwriters have united, on more than one occasion, in opposition to efforts which legislative committees and insurance departments have made to ascertain the secrets of fire insurance rate-making, in so far as these are ascertainable. They have protested that, in the very nature of things, fire insurance rate-making cannot be reduced to an exact science, or anything approaching one, and that, therefore, the filing by fire insurance companies of their "experience" in tabulated form, according to some uniform system — or any of the other similar suggestions which have been made from time to time — would do more harm than good and would not supply the public with any real information respecting the manner in which fire insurance rates are arrived at. "These statistics," say the fire insurance underwriters, "when kept by ourselves according to our own system — each one of which systems differs materially from the systems employed by others — are of a certain amount of value to us in determining what kinds of business are profitable and what kinds are not, and the information contained in them is used by us more or less in making rates. But they would be absolutely meaningless to the general public. Standing by themselves, they would furnish no real explanation of how we arrive at our rates. In fact, we don't ourselves know exactly how we do it. What it comes down to is this, that we have spent our lives in the business of fire underwriting, and in consequence are experts in this business — and after we take into account all the statistical experience at our disposal, we make up our minds what rates may safely be charged in any line, by simply using the best judgment that we possess. Precisely *how* we do it, or *why* we arrive at any

given result, is not susceptible of exact explanation. Rate-making is a fine art, in other words, not an exact science; and the public would only be confused by the filing of the past experience of companies. For that reason, we protest against any such requirement."

This, very roughly stated, is the position which the leading men in the fire insurance world have been taking lately in reference to the proposal which the New York Department advanced about a year ago to the effect that the "experience" of the companies should hereafter be filed with the Department as a guide in determining whether in any given case the rates charged were fair. Let me say at once that, personally, I sympathize with their attitude to a very considerable extent, because I have every reason to believe that the distinction which they draw between their business, as a highly hazardous calling, and the business of life insurance for instance — from which the element of chance has largely been eliminated — is a very real distinction, and not in the least an imaginary one. But admitting this to be true, we are still confronted with the question, what the proper limits of governmental activity are in connection with this business, and this is the question I am going to try to discuss briefly here to-day. But first let me point out why I think that increased governmental activity in connection with fire insurance rate-making is more or less inevitable. Having done that, we will take up the further question what line of governmental activity should be followed by self-respecting commonwealths, in reference to this matter, during the coming years.

In my judgment, increased governmental activity in connection with the fire insurance business is inevitable, for some time to come, in New York and elsewhere — if for no other reason because in respect to fire insurance, as in respect to most other kinds of business activity, the world in its progress has left the age of competition behind, and has passed into an era when co-operation, not competition, shall be the controlling watchword. This, of course, is not literally and completely the situation — I am endeavoring merely to describe the tendency and the drift of things. The drift in the fire insurance world has been the same as elsewhere. It has been in the direction of doing away with

the sharp competition which once existed in the business. Now, if there is one thing that can be taken as absolutely settled in connection with the trend of popular thought in this country, it is that the moment competition dies out or languishes in any industry, at that same moment a demand arises that the government shall become active, either in supervising or conducting the business which has ceased to be affected by competition.

In fire insurance, the companies commenced some years ago to co-operate in the matter of rate-making. They did this by means of variously devised methods of organization suited to the purpose. In some cases, they subscribed to tables of rates made up by individual experts upon supposedly scientific principles, and agreed to be bound by these rates. In other cases, they organized rate-making bodies of their own. The effect in either case was the same, in that the throat-cutting competition which once existed virtually came to an end.

It was inevitable, as I have said, that this tendency should have been met by a stirring up, throughout the United States, of popular interest in the question what effect the new order of things was going to have on fire insurance rates. The different positions which people in different parts of the country, acting through their legislatures and insurance departments, have been taking on this matter shows — if it shows nothing else — how crude and unsettled popular thought still is on the subject. Certainly no adjustment of the situation that can be regarded as in any sense final has been reached anywhere. In some places, the popular view seems to be that this tendency toward co-operative effort upon the part of those engaged in the business of fire insurance should be combated by every means possible. All combinations having for their purpose the achievement of uniformity in rates between the companies should, in the opinion of some, be legislated against and broken up. Those who do not desire to compete should be made to compete, whether they wish to or not. If they refuse to compete and try to co-operate, they should be sent to jail and their business should be taken away from them. That, I say, has been the point of view of some. It is not my point of view. It is not the policy which has found favor in the State of New York.

In New York we have concluded, on the whole, that the tendency toward co-operative effort between the companies in the matter of rate-making is, besides being inevitable, a tendency wholly in the right direction. The evils of the old unrestrained competition were many, and the wastefulness of it was great. The effect of it on the solvency of the companies which sold the indispensable commodity of insurance to the public could not help being, in many cases, disastrous. Rate wars led to company failures, and company failures led to unsafe insurance. Under the old conditions this was inevitable, and I, for one, hope never to see those so-called "good old days" return.

But, of course, with the passing of competition the people commenced to develop a curiosity, which has ever been growing greater instead of less, as to how the more or less standard rates which they have to pay under the new system, no matter what company they insure in, are arrived at. If a man can go from company to company getting the lowest rate possible for the insurance he requires, he is not apt to care very much how the rate is arrived at. Why? Because he knows that by virtue of the mere fact that competition exists, he will be able to get as low a rate as can with safety be granted — maybe a lower one. But when competition is eliminated, he has no such comfortable assurance. In the absence of it, the dread spectre of a grinding and all-powerful monopoly, dictating for purposes of private profit the raising of rates to an exorbitant figure, inevitably takes possession of the average man's mind. To whom shall he turn for protection, he asks himself. And the answer of course is — to the State.

Thus in New York and elsewhere we were compelled, very shortly after the tendency to which I have referred manifested itself, to consider very carefully the question of the position which the State should take toward these rate-making combinations. Should we try to break them up by law and restore the old conditions? Or should we recognize the fact that co-operation as a substitute for competition is both inevitable and desirable, and legalize it under proper restrictions and with proper safeguards?

New York decided upon the latter plan and, on the whole, I think the results thus far have amply justified us in our choice.

No single State, of course, can deal unaided with the problem of fire insurance rate-making and hope to solve it completely. It depends, in the first place, upon many things which are entirely beyond State control — upon the fundamental morality of people, for instance, and upon special conditions which exist here and there and which no legislation, however well intended, can affect. But beyond all this, rates in any given State are necessarily affected, in large measure, by the laws which are passed in the other States. As the result of its entire underwriting each company tries to make money for its stockholders. If through restrictive legislation it loses money in Kansas, Kentucky or Missouri, for instance, it naturally seeks to recoup itself somewhere else. Thus, as I say, the question is a national one and, in the very nature of things, cannot be dealt with satisfactorily by any single State. But that we in New York are meeting the difficulties of the situation in as satisfactory a manner as they can be met under the circumstances, I think I am perfectly safe in stating.

What we have done in New York is simply this: We have recognized the need for rate-making associations, and have explicitly legalized these organisms so that they may transact their business in the open and not, in fear and trembling, behind closed doors. We have placed them, together with all their ramifications and feeders, under the supervisory jurisdiction of the Insurance Department. We have, in addition, passed laws forbidding the making of discriminatory rates between risks of the same class. We have given authority to the head of the Insurance Department to pass upon questions of alleged discrimination of this character, and, if he finds such discrimination to exist, to forthwith order it removed. That has been the New York way of dealing with the situation which has resulted, in the fire insurance world, from the dying-out of the old thorough-going competition between the companies which once existed in the matter of rates. And, as I have said, it has proved to be a very good way so far as it goes. It has enabled us, on several occasions to bring about — with the approval, virtually, of the companies themselves — large reductions in rates which were being charged in sections of New York and other cities where conditions had

entirely changed since these rates were first put into effect. But for the power which any citizen has, under the New York law, to lodge a complaint of discrimination in such cases with the Superintendent of Insurance, these antiquated rating schedules would so far as one can see, have remained in operation indefinitely — largely because with the best will in the world it is humanly impossible for the rate-making organism, unless prodded along from the outside, to keep abreast of the changes which are occurring constantly in the territories they are supposed to cover. Thus it came about, in one case I have in mind, that the department's order removing an obvious discrimination in rates against an extensive outlying section of one of our greatest cities, was hailed by the companies themselves with almost as much enthusiasm as it was by the inhabitants of the region benefited by the order — because the justice of the finding was beyond any question and the insurance companies realized that in calling it to their attention, and insisting upon prompt action, the department was really doing a service to them as well as to the people.

Am I not justified, then, in contending that excellent progress has been made in New York toward solving the difficult question of what should be the proper relationship, in the future, between government and the business of fire insurance? Infinitely better progress, at all events, has been made, I am certain, than would have been possible had we gone into the matter from a different angle, and sought to annihilate the rate-making bodies, as has been attempted in some of the States. Nevertheless, when all is said and done, it must be admitted that in New York, as elsewhere, a feeling of suspicion exists in the minds of people generally that fire insurance rates are higher than they ought to be. Hand in hand with this suspicion goes the demand that the people shall be afforded an opportunity — by studying the figures showing past experience upon which present rates are predicated — to sit in judgment, as it were, from time to time, through their proper representatives, upon the question whether the price they are paying for fire insurance protection, now that competition has been eliminated, is a fair price or not. And he would be a venturesome prophet indeed who was willing to record himself as thinking that this demand will speedily die out.

This brings me to the point where, if I have any further solution of the problem than the one now on trial in New York, it is proper that I should divulge it. I have already said that I think that the New York method of handling the situation has been a good one, so far as it goes. I am not yet prepared to say that it does not go as far as need ever be gone in the direction of governmental supervision over the question of fire insurance rates. The results accomplished so far have been satisfactory enough to encourage the hope at least that, with further trial, the present New York method will show that it is capable of meeting all the requirements of the case. But, if this should turn out not to be so — if there should be a necessity for further State activity in this field — a suggestion has recently been made to me as to the direction which this activity should take, and without in any sense adopting it as my own I am going to tell you what it is, for whatever it may be worth. I hope my action in mentioning it at this time will be accepted by those in the fire insurance business in the spirit in which it is intended — that is, as an honest and sincere attempt to contribute something helpful to the public discussion of an exceedingly intricate and troublesome question.

Insurance departments exist primarily in order to insure the solvency of insurance companies operating within the jurisdiction of these departments. Anything which it may be necessary to do in the direction of State activity in the rate-making field, beyond what has already been done in New York, should, in my judgment, be done in connection with the performance of this admitted and well-recognized duty of insurance departments — namely, the maintenance of solvency among the insurance companies. The question of solvency can best be dealt with by requiring the maintenance of adequate reserves by the companies. In order to know whether a reserve is adequate or not, it is necessary to know what the hazard is, or in other words, the anticipated loss. The net premium rate is the measure of the hazard, and reserves should be based upon true net premiums. Theoretically, therefore, insurance departments, in order to carry out their primary purpose of safeguarding the solvency of companies, should not only know what the true net premiums are upon which the companies base their reserves, but should have the equipment for

determining what rates may be justly charged by the companies in order to maintain solvency and insure a fair return upon the capital invested.

I believe that the scope of State authority in the matter of making rates should, under any and all circumstances that I can conceive of, be limited to the field outlined above, namely, the safeguarding of solvency. I do not believe that under any conceivable circumstances the State should undertake to do anything in the direction of making rates which it shall be obligatory upon insurance companies to charge their customers. But I know that a good many thoughtful people see a certain virtue in the idea that it may prove desirable some day for States to have something to say about the making of the rates upon which the companies' reserves are calculated — leaving the companies then to actually charge such rates as they see fit, so long as they reserve upon the rates which have received departmental approval. If State rate-making confines itself to the single purpose above outlined, it would be stripped, they say, of all the terrors which it now has for the men who are leaders in the fire insurance business of the country. No strong fire insurance concern has any objection whatever, so far as I know, to the maintenance of any reserves which in the interest of safety they may reasonably be called upon to maintain. To maintain strong reserves — even to err in this respect upon the side of safety — takes no money out of the companies' pockets. It simply makes the insurance which they sell safer. The companies might under certain conditions, therefore, have no serious objection to State rate-making, if the rates so made were made for no other purpose than to calculate safe reserves upon — if, in other words, the rates so made were not made as compulsory rates to be charged by the companies.

Does the question of State rate-making, viewed from this angle, clear itself a little? Does this suggestion point to a way out of existing difficulties and uncertainties? I am far from thinking that immediate steps must necessarily be taken along this line. I only say that, if the agitation in favor of State rate-making continues, this is perhaps the channel into which it should be directed — the channel into which, if it *is* directed, will result in the maximum of good and the minimum of harm coming to

the business of fire insurance in private hands. The procedure would be, I suppose, that the rates would be made, in the first instance, by rate-making bodies or bureaus, as at present, and submitted to the Insurance Department together with the classified experience of the companies. These rates and schedules would be approved by the department upon the basis of a study of collected experience, by qualified experts in the employ of the State. The rates so approved would be the minimum basis for reserves, but in no other sense would be mandatory or binding upon the companies.

Does this sound revolutionary or dangerous? It is not so intended. At all events, it is the only suggestion I am able to make now as to what the future attitude of government might conceivably be, under certain circumstances, toward the problem of fire insurance rate-making. I shall be interested to see what criticisms it calls forth. That it would, if adopted, inevitably lead to a larger measure of supervision and control by government over fire insurance companies than now exists, is undoubtedly true. I should be the first to regret this, because I am so incorrigibly an individualist, in matters of this kind, that I continue to believe, with Thomas Jefferson, that the least governmental machinery we can get along with, the better off we will all of us be. I approach the whole question of Insurance Supervision from that standpoint. I agree that we should have just as little Insurance Supervision as possible. Where I differ from some of the men who are now active in the business of fire insurance is merely over the question what, under existing conditions, the least possible measure of State activity in insurance matters is. I am afraid that what sufficed, in this respect during the days when conditions of life were simple, and before the great commercial and social developments and changes of the present time had occurred, no longer meets the needs of the situation.

To recapitulate. I entirely understand, and to a considerable extent sympathize with, the reluctant attitude of the older fire insurance men toward anything which savors of governmental aggression in their chosen field. They are engaged in a very peculiar and essentially hazardous business — one in which expert knowledge is absolutely necessary in order to succeed — and I

do not in the least blame the men who have grown gray in this business for viewing with alarm the increased activities of the government in respect to their affairs. It is the last business in the world that the people ought to be eager in their organized capacity, to engage in. It differs altogether from life insurance in this respect — although I do not want to be understood as favoring State insurance in the life field either, for I certainly do not favor it. But the time has come, I think, when broad-minded fire insurance men must recognize the inevitable drift of things. They must view their problem in the light of actual conditions, not in the light of conditions as they would like them to exist. They must recognize the universality of the demand for good cheap insurance, and the utter dependence of the people upon it. They must appreciate the truth of the proposition that, after competition has died out in any branch of business, and monopoly reigns in its stead, the only direction in which men can look for protection against the possible abuses attendant upon monopolistic conditions, is the State. Monopoly having to a greater or less degree taken the place of the old competition in the fire insurance field, the leaders in the fire insurance business should realize that henceforth they must adopt a different attitude toward governmental activities in connection with fire insurance. I am very sure that the strong men who have performed such wonders in this useful field of work will readjust themselves very quickly to the new conditions. In so doing, they will be establishing additional grounds, besides the many which now exist, for the praise which no right-thinking man will withhold from them for all the splendid results they have achieved. And they will be taking the final step necessary to place their great business — without which the affairs of the world could not be carried on at all — upon a sounder foundation than it has ever yet occupied.